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Abstract

Benefits of financial market integration across different economies have motivated a series of mergers and acquisitions, and electronic trading link-ups across regional financial markets. Drawing on institutional theory, we look beyond technological solutions to surface strategies in tackling the institutional challenges in the context of cross-border financial market integration. Through an interpretative case study of ASEAN Exchanges, we found that successful market integration requires the active lobbying of regulators to gain regulative legitimacy, peer socialization within the profession to attain normative legitimacy, and the reframing of mindsets through education, publicity and new symbolic artifacts to achieve cultural-cognitive legitimacy. Results highlight the importance for entrepreneurial focal actors to adopt an institutional lens and its respective strategies to enhance the success of technology implementation in a highly institutionalized context.

Keywords: Technology implementation, financial market integration, institutional theory, institutional entrepreneurship, ASEAN Exchanges

1 INTRODUCTION

The development of financial market integration across different economies is generally built on the potential advantages of increasing capital liquidity, generating capital flows, diversifying international investment risks and stimulating investment growth (Obstfeld 1998; Arourie, Jawadi & Nguyen 2010; Bekaert et al. 2005). According to Prasad et al. (2003), increased integration of global markets begets improvement in market efficiency, and promotes growth in developing countries whilst helping countries reduce macroeconomic volatility. Further, with better functioning intermediaries involved, market integration can improve resource allocation and accelerate productivity (Beck et al. 2000).

Over the past two decades, we have witnessed a series of merger and acquisition (M&A) and trading link-up activities for both regional and global financial markets. These developments include the convergence of European bond and money markets during the late 1990s, the formation of Euronext in 2000, the Latin American Integrated Market (known as MILA) recently formed by South American countries; and the establishment of Shanghai-Hong Stock Connect in 2014.

While financial market integrations bear significant economic potential, successful implementations are elusive. Thus far, attempts to merger failed due to various challenges: To illustrate, the merger between TMX Group and London Stock Exchange (LSE) fell through in 2011 on nationalistic grounds; in 2012, to prevent near-monopolizing of European financial derivatives market, the European Commission vetoed the merger of NYSE Euronext and Deutsche Börse. Even with a sophisticated trading structure, institutional challenges obscure market integration. The ASEAN Exchanges is an example where, launched in 2012 with a promise of stimulating capital within ASEAN, has yet live up to expectations. Hence, that it is imperative to go beyond economic rationality and look at institutional challenges in implementing market integration initiatives.

Departing from mere economic analysis, we draw on institutional theory to conduct an interpretative case study exploring institutional challenges in implementing ASEAN Exchanges and strategies employed to tackle them. In the following sections, we review the literature on financial market integration, describe the methodological approach and present our preliminary findings. We conclude with our contributions, discuss the limitations and future research directions.

2 BACKGROUND LITERATURE: MARKET INTEGRATION

Financial market integration is the process of alliances, mergers and cooperation between stock and derivatives exchanges for the purpose of increasing the value of stock markets. Any investor located within the geographical boundaries is unconstrained by the size of the financial markets (Cybo-Ottone et al. 2000; Domowitz 1995; Domowitz & Steil 1999; Hasan & Schmiedal 2004; Lee 1998; Guiso, Jappelli, Padula & Pagano 2004). In recent years, scholars have noted the increasing convergence of international stock markets (Karolyi & Stulz 2001; Eun & Lee 2010; Mishkin 2007). Much of early examinations of financial market integration were focused on its economic impacts encompassing economic benefits and risk diversification. Most arguments supporting financial openness indicated that despite associated risks, economic benefits of market integration far outweighs its risks. These arguments considered benefits of international risk sharing for consumption smoothing, increased in domestic investment and growth, enhanced macroeconomic discipline, and increased efficiency and stability of domestic financial system that comes with the penetration of foreign banks (Agénor 2003; Dorodnyk 2014). Consistent with these findings, Guiso, Kappelli, Padula & Pagano (2004) found that from a sample of 22 European countries, financial integration had a positive effect on countries' and sectors' growth especially in SMEs located in countries with weak financial structure.

While advocates demonstrated the benefits of economic growth and risk diversification, critics are cautious about institutional conditions needed to realize economic gains and risk mitigation. Institutional scholars go beyond the viewpoint of markets as a system of economic exchange for the simple objective of resource allocation efficiency and uncertainties avoidance, emphasizing the broader level of legal, cultural, and social context in which political and social belief systems influence and shape the rules and operations of financial markets (Preda 2007; Carruthers & Kim 2011). In other words, the dynamics of market development cannot be separated from the understanding of its underlying institutional context. For example, the case of nearly 40-year European market integration cannot be understood alone without considering embedded pan-regional laws, single currency, social belief systems and dynamic interactions that reshaped market rules (Fligstein & Sweet 2002). Other researchers seek to broaden the measurement of financial market integration beyond just economic indicators to include regulative indicators such as legal system level of development (see Adam, Jappelli, Menichini, Padula & Pagano 2002; Edison 2002).

While growing body of works recognizes institutional challenges in various contexts, there remains a paucity of research investigating strategies to tackle institutional challenges in driving market integration. Existing literature tends to focus on exploring comparative economic advantages of financial market integration, and does not explore the implementation strategies, especially on how an integrated financial market gains legitimacy to diffuse successfully. Thus, our study addresses this gap to understand institutional challenges arising from market integration, and the strategies in overcoming these challenges.

3 AN INSTITUTIONAL PERSPECTIVE TO FINANCIAL MARKET INTEGRATION

3.1 Institutional Perspective: The Three Pillars

From an institutional perspective, an initiative must gain institutional legitimacy to diffuse successfully. Institutional theorists argued that the environment presents a set of rules, norms and beliefs that organizations should conform to gain legitimacy for survival (DiMaggio & Powell 1983); the sources of legitimacy are regulative, normative and cultural-cognitive in nature (Scott, 1995).

The regulative pillar concerns formal rules and existing laws in a particular environment, exerting coercive pressure to conform (i.e., what people can or cannot do). According to Scott (1995), the regulative aspect deals with the establishment of regulation and the associated mechanisms that monitor and enforce regulation compliance, and resolve disputes. The power of legal sanctioning provides legitimacy as non-compliance is penalized.

The normative component refers to societal values and norms that prescribe the desirable and appropriate behaviors, exerting normative pressure to conform (i.e., what people should or should not do). Specifically, *values* are the benchmark of shared constructs of desirable behaviors and thoughts in society whilst *norms* are the legitimate means of how things are accomplished. The normative pillar basis of legitimacy is morally governed. Socialization in the form of accreditation or certification can be used as a means to attain desirable goals within an institutional setting.

The cultural-cognitive pillar describes prevailing cultural beliefs rooted in an institutional environment that shape the interpretive schemas people use when selecting and processing information. Unlike desirable norms, it addresses the symbolic and interpretative nature of human activities in a society. The basis of legitimacy is recognizable whilst being culturally supported, exerting mimetic pressure to conform (i.e., what people typically do or not do).

Together, these three institutional forces present significant legitimacy challenges for the diffusion of new practices. It is critical for an institution to gain legitimacy as its acceptance enables access to more resources. Thus, for successful diffusion, a new market integration initiative must deal with challenges posed by institutional forces. Past literature on institutional entrepreneurship explored strategies to deal with institutional challenges. Oliver (1991) contended that organizations tend to respond generally by acquiescing, compromising, avoiding, defying and manipulation. Where organizations can conform to institutional forces with minimal consequences, they should; in areas where they cannot, these institutional forces will present themselves as challenges and need to be creatively addressed for attaining legitimacy by departing from extant institutional logics.

3.2 Institutional Entrepreneurship and Strategies to Deal with Institutional Challenges

Institutional entrepreneurs are organizational actors who envision new institutors as a means of advancing highly valued interests despite being suppressed by extant logics and practices (DiMaggio 1988; Henfridsson & Yoo 2013). Present literature thus far recognized that although institutional change is a feat, it is possible and can be led by incumbent organizational actors. As noted by Scott (2011), “In highly institutionalized systems, endogenous change seems almost to contradict the meaning of institution” bringing about the paradox of embedded agency (Clemens & Cook 1999; Seo and Creed 2002; Sewell 1992). Contrary to institutional discourse, incumbents can change entrenched practices if they are motivated by adverse performance feedback, aware of alternative possibilities through unique access to global clients, and open to new ideas due to significant asymmetry of resources caused by widening misalignment of regulatory and market boundaries (Greenwood & Suddaby 2006).

To initiate institutional change readily, organizations often urge regulatory organizations, including legislators and courts, for policies to adapt to new situations via litigation and lobbying. As observed by Fligstein and Sweet (2002) in the European Community (EC), the European Court of Justice serve as an authoritative figure enforcing treaties and secondary legislation, and tackling litigation brought by organizations, individuals and states; further, following the enactment of the Single European Act in 1985 in the EC, new lobbying groups, mostly engaging in cross-border transactions, were formed to lobby their national governments and the European Commission for favorable rules to liberalize markets and replace national regulations with Europeans’. Hence, through litigation, lobbying and legislature, organizations could successfully address institutional challenges in the financial markets.

Besides effecting change at a regulatory level, growing literature has suggested instigating institutional changes through a multilevel model approach (Tracey, Phillips & Jarvis 2011; Bell Filatotchev & Rasheed 2012). Specifically, institutional strategies at individual, organizational, and macro levels were necessary to legitimize novel organizational form in new context; To do so, organizational actively reframed problems, engaged in counterfactual thinking, build and theorized the organizational template (Tracey et al. 2011), connected with macro-level discourses, and aligned with highly legitimate and influential actors by striving for organizational isomorphism with said actors (Tracey et al. 2011; Bell et al. 2012). Other measures to mitigate the “liability of foreignness” include the need to undergo stricter regulations, to signal good governance and to secure reputational endorsement by credible third parties (Bell et al. 2012).

Expanding on the multilevel model approach, incumbents can tackle institutional challenges holistically by actively developing an innovation trajectory to redirect new innovation practices. Henfridsson and Yoo (2013) found that to depart from extant industry logic, institutional entrepreneurs adopt a “design attitude” characterized by departing from established norms, envisioning an alternate future and imagined solution, and experimenting with varied solutions before fermenting the best fit solution to actualize their new vision.

Overall, prior research provides a lens that sensitizes us to various strategies employed in facilitating the institutional change. As we proceed to analyze the implementation of financial market integration initiative along the three sources of institutional challenges, we are cognizant of similar actions taken by various actors in their efforts to initiate institutional change.

4 RESEARCH METHODOLOGY

This study investigated cross-border challenges of financial market integration in the context of ASEAN Exchanges, as the initiative fulfilled the criteria of being in implementation phase and access to contacts was generously provided by SWIFT Institute. Through an interpretive case approach, we surface related institutional challenges in implementing ASEAN Exchanges. The strengths of interpretive case studies include investigating socially constructed meaning that are embedded within natural settings, and intertwined with practices and consequences of participants' social actions.

Our data collection focused on discourses related to development decisions on ASEAN Exchanges, its implementation motivations, and the barriers for cross-ASEAN securities trading. We first gathered secondary information to gain a broad understanding about the current state and challenges related to the ASEAN Exchanges. We then travelled to ASEAN countries, carried out in-depth interviews with various stakeholders from stock exchanges, clearing houses, CSDs, and service providers. Between July 2014 and July 2015, 15 face-to-face interviews (individually and in groups) and 2 email interviews were conducted with the CEO and senior managers from the Singapore Stock Exchange, Indonesia Stock Exchange, Bursa Malaysia, Stock Exchange of Thailand, Philippines Stock Exchange, Deutsche Bank and SunGard. Given the sensitive and political nature of views expressed by our interviewees, identities of sources are protected in this paper.

4.1 ASEAN Exchanges

Aspiring to raise their economic competitiveness, the ASEAN countries foregathered to push for deeper regional financial integration. A key commitment is the establishment of the ASEAN Economic Community (AEC) by 2015. This optimism is reflected in the rapid growth of the region where the ASEAN economies were projected to have real GDP growth by 5.5% per annum in 2013 and 2014 (ASEAN Integration Report, 2015). One key initiative under AEC is the formation of ASEAN Exchange - an integration of seven stock exchanges in Indonesia (IDX), Malaysia (BM), Philippines (PSE), Singapore (SGX), Thailand (SET), and Vietnam (HNX, HOSE). Such collaboration across ASEAN Exchanges is expected to streamline access to ASEAN capital markets with various benefits such attracting investment into the region. The aspiration for an integrated cross-ASEAN trading infrastructure would enable greater market participation from various stakeholders and investors, particularly smaller stockbrokers and individual retail investors who lack access to such trading facilities.

4.2 ASEAN Stock Trading Link

In 2012, ASEAN Trading Link, a cross-ASEAN trading technology infrastructure was launched. It provides a standard interface for ASEAN trades, with a single point of access for market data and order routing for all existing ASEAN members and global investors. There are two main components in the ASEAN Trading Link that facilitates efficient straight-through processing: The technology infrastructure - Intra ASEAN network - comprised a fiber network that connects various national exchanges; and the ASEAN Common Exchange gateways - a series of hubs located at each exchange, which provide the connecting point for brokers and exchanges. The development and maintenance of the entire technology infrastructure is outsourced to SunGard as a third-party vendor where it ensures its service offerings to be scalable and flexible – dependent on usage, additional modules required, and member countries can choose to join the ASEAN Trading Link later without causing any disruption.

Cross border trading operations follows an inter-broker model where "home rules apply", requiring investors to abide by the business rules of the home country where shares are transacted. "Home rule apply" addresses incongruent market practices issues with jurisdiction such that home brokers are not bypassed. For post-settlement operations, Deutsche Bank, the selected global payment/custodian bank, works closely with the respective exchanges to cater to their unique local requirements (e.g., initial system customization to accommodate different account structures or market regulatory requirements) so that no changes are needed to existing post-trade processing in each country.

The ASEAN Trading Link not only streamlines trading arrangements for brokers, but also reduces investment and operational costs to access the exchanges in other ASEAN countries, particularly for mid-and-small brokers. As such, its "plug and play" infrastructure ensures efficiency and seamless trading for brokers to access other exchanges.

5 RESEARCH FINDINGS: LEGITIMACY CHALLENGES OF CROSS-ASEAN SECURITIES TRADING

While ASEAN Exchanges supported by the Trading Link was technologically sound and operationally feasible, the volume of cross-border securities trading in ASEAN Exchanges remained small. Unlike project level changes, institutional changes take time as they involve changing underlying regulative, normative, and cultural-cognitive contexts. Despite difficulties, our preliminary findings demonstrated how institutional entrepreneurs actively strive to ensure legitimacy. For instance, regulative challenges are resolved through lobbying efforts by ASEAN Exchanges' working groups; normative challenges are rectified via active peer socialization to raise professional norms; cultural-cognitive challenges are settled by reframing preconceived notions of investments (see Figure 1). The following section expands on our analysis of institutional challenges and the related attempts to address these three challenges can be observed below.

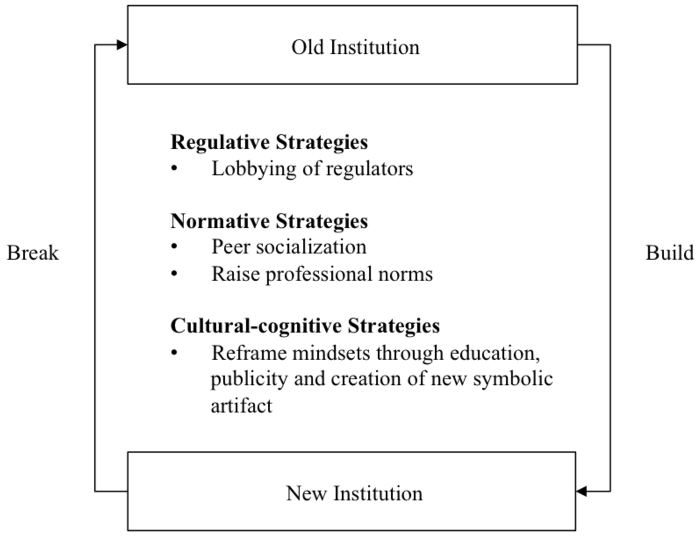

Figure 1. Cycle of Institutional Change

5.1 Regulative Legitimacy Challenges

For ASEAN Exchanges to thrive, investors should be able to invest freely within ASEAN region. However, disparities in market policies, tax regimes, legal jurisdictions, foreign investment restrictions and investment protection policies, investors remain hesitant to invest in their ASEAN counterparts. For example, issues may arise from disparities between Indonesia's legal tradition inherited from the colonial Dutch and Malaysia and Singapore's British common law system. The different legal jurisdictions are relevant in ensuring enforceability of remedies and impartiality of arbitration in situations of dispute settlement. Other uncertainties include the custody arrangements and beneficial ownership structure of custody accounts, the enforceability of netting and of novation for the purpose of final settlement, and the irrevocability and finality of trade settlement.

5.1.1 Institutional Strategies – Active Lobbying of Regulators

To overcome regulative challenges, active lobbying efforts of ASEAN Exchanges working group lowered some regulatory barriers. To illustrate, as a result of lobbying by ASEAN Exchange working group, the Thai government relaxed its capital gain tax and withheld tax dividends; additionally, Thai investors can now hold a foreign currency account by opening an account with Bank of Thailand. Similarly, policies prohibiting retail investors in the Philippines from buying non-locally registered securities may soon be relaxed to facilitate trading on ASEAN Exchanges. Further, ASEAN

Exchanges members proactively lobby ASEAN Capital Market Forum (ACMF), a forum comprising the heads of securities regulators in ASEAN. One push was for ACMF to develop the ASEAN Disclosure Standards Scheme in 2013, single set of fully harmonized disclosure standards, which was based on standards on cross-border equity offerings set by the International Organization of Securities Commissions' (IOSCO). A similar strategy was also employed to tackle multi-jurisdictional collective investment schemes (CIS) under ASEAN Framework for Cross-Border of CIS that resulted in the development of Asia Fund Passport concept such that CIS such as mutual funds approved in one ASEAN country could be approved and sold to another ASEAN country without undergoing registration and other formalities in the latter country.

5.2 Normative Legitimacy Challenges

Although the exchanges were increasingly adopting standardized trading platforms to stay competitive, challenges such as inconsistent trading norms, market practices and industry guidelines existed between ASEAN Exchanges and its members. Different degree of fragmentation in trading, clearing, and settlement activities engendered different "acceptable" behaviors among market players in different countries. Dissimilarities in ownership structure between privately owned IDX and demutualized SGX might result in different assessment of business decisions that affects efficiency of implementing ASEAN Exchanges. The extent of fragmentation between clearing and settlement entities also differs: entities are separated in some countries (e.g., Indonesia, Malaysia, and Philippines) and integrated in others (e.g., Singapore, Thailand, and Vietnam). Additionally, different permissibility around netting and segregation of trading accounts (e.g., the use of omnibus account), and the different clearing and settlement cycles (e.g., T+2, T+3) coupled with differences in time zones, business calendars (e.g., holidays) or operating hours (e.g., lunchtime trading) could cause trading or settlement delays. Hence, the lack of harmonization led to uncertainty and inefficiency in cross-border trading, consequently causing investors to be reluctant to transact in ASEAN Exchanges.

5.2.1 Institutional Strategies – Peer Socialization to Raise Professional Norms

To harmonize trading practices, ASEAN Exchanges' members regularly engaged in regional forums to exert pressure on members via peer sharing of experiences in adopting industry best practices, international standards, harmonizing listing rules, establishing corporate governance and disclosure standards. Hitherto, at least four socialization forums on ASEAN Comprehensive Investment Agreement were held for business and private sector adherents in Malaysia, the Philippines, Indonesia and Brunei Darussalam from 2013 to 2015. Additionally, Indonesia upgraded its IT system to enable straight-through processing and align with ASEAN Exchanges. Similarly, in June 2015, PSE launched a new PSETradex online trading platform developed by NASDAQ that is also utilized by BM, SGX and IDX. Such sharing accelerated the respective countries' capital development plans to facilitate cross-ASEAN integration. Further, PSE worked with ASEAN counterparts (BM and IDX) to increase the sophistication of its product offerings by developing a list of syariah-compliant stocks.

One common narrative among ASEAN Exchanges members was connecting to the macro level discourse of establishing AEC. Members often point to the goals of AEC of developing a highly competitive region by fostering a single market with a freer flow of goods and services within ASEAN, attaining equitable economic development, and achieving greater integration into the global economy. Thus, the AEC rhetoric seems to be a common unifying vision that galvanizes the commitments of the various exchanges.

5.3 Cultural-Cognitive Legitimacy Challenges

Although ASEAN Exchanges targeted retail investors, typical retail investors were entrenched in a saving culture, averse to trading as it is sometimes perceived as gambling. Our interview highlighted that in Indonesia, for example, the challenge of transforming Indonesia "from a savings society to a trading society" remains. For IDX, about 477,000 people (0.19% of the total population) were listed as registered investors. Additionally, according to Shimzu (2014), only 9% of Singaporeans invest in stocks compared to 35% in Hong Kong and 17% in Australia; retail investors account for only 20% of transactions in Malaysia compared to 60% in South Korea. Moreover, investors are generally unaware of investible companies in ASEAN. Trading transactions, if any, are focused on local companies. Even for experienced investors, few are aware of listed companies in other ASEAN countries due to lack of visibility in their social and cultural surroundings.

5.3.1 Institutional Strategies – Reframing Mindsets through Education, Publicity, and the Creation of New Symbolic Artefacts

To address these issues, the exchanges actively reframe the notion of trading securities as a viable alternative to saving. Our interviews revealed that an investment culture among ASEAN countries was fostered through financial education to raise investment literacy. Launched in August 2013, the ASEAN Investment online portal provided a one-stop information gateway about ASEAN as a single investment destination. Outbound missions from ASEAN-6 to CLMV were also made between 2012 and 2014. To reach out to potential investors, partnerships with universities, setting up an investment outpost (Indonesia), and TV and media publicity (Thailand) were developed. Apart from promoting intra-regional investment, trade and investment road shows were held in the US to increase the visibility of ASEAN to the US business community (ASEAN Integration Report 2015).

Further, ASEAN Exchanges actively promoted ASEAN as an asset class; For instance, it introduced FTSE ASEAN Index Series that encompasses a suite of indices of ASEAN equity market. Its tradable indices are FTSE ASEAN All-Share Index, FTSE ASEAN Sector Indices, FTSE/ASEAN 40 Index and FTSE ASEAN Stars Index. These indices serve as tools for creating index tracking funds, derivatives and as performance benchmark. ASEAN Exchanges further garnered the support of its traders by partnering with well-recognized regional bank CIMB to launch these products. As of January 23, 2015, the FTSE ASEAN Stars registered a 12-month 10.8% total return in terms of market performance (FTSE Group 2015).

6 DISCUSSION

The case of ASEAN Exchanges clearly re-affirms that despite technological readiness, it is a feat to successfully diffuse institutional innovations. Hence, crafting a compelling rhetoric for change is crucial at every level – the community, professional, and regulator. Such efforts require lobbying of regulators, peer socialization to raise professional norms and standards, reframing of problems and creating new symbolic artifacts to counter existing mindsets, and building perceived legitimacy by connecting to macro-level discourses, and alignment with other credible actors. These efforts facilitated institutional changes as they incrementally and interactively served to enhance the legitimacy of new practices of ASEAN Exchanges.

As the market evolves with the disruptions of entrants, institutional entrepreneurs must constantly break old practices to make way for new ones to remain relevant through sustained momentum (see Figure 1). While employing strategies to deal with institutional challenges, Garud and Karnøe (2001) emphasized the importance of generating buzz and momentum to harness the cumulative efforts of other non-focal market actors. Hence, future research could explore the collective efforts of multiple parties involved and the sustained efforts are required to successfully establish a financial market's institutional legitimacy.

This paper thus contributes to the literature by bringing a broader view to technology implementation. For a successful marketing integration, it is insufficient to talk about managing technology implementation at the project level; there is also a need to actively instigate change at the institutional level. This is particularly relevant for technology implementation in a heavily institutionalized context, as characterized in this case, by the highly regulated financial industry and the cross-country context of the ASEAN Exchanges.

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